

STATE OF ALASKA

DEPARTMENT OF REVENUE

OFFICE OF THE COMMISSIONER

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March 2, 2004

President of the Senate/Speaker of the House
House and Senate Finance Committee Members
Alaska State Capitol
Juneau, AK 99801

Dear State Legislator:

AS 37.10.430(b) requires that:

[b]y March 15 of each year, the Department of Revenue shall, after consulting with the Alaska Permanent Fund Corporation, prepare a report setting out the balance in the budget reserve fund (art. IX, sec. 17, Constitution of the State of Alaska) on January 1 and on December 31 of the previous calendar year. The report shall state the nominal, real, and realized return on the budget reserve fund compared to the nominal, real, and realized return on the permanent fund and the general fund during the previous calendar year.

The required report is enclosed.

Page 1 sets forth the fund balances for the Constitutional Budget Reserve Fund (CBRF).

Page 2 provides comparative annual rates of return. The difference in performance reflected on page 2 of the report results primarily from the differences in asset allocation among the funds and the relative performance between the comparable asset classes.

Page 3 provides comparisons of these fund asset allocations at December 31, 2003. Since the General Fund has a moderate risk tolerance and high liquidity requirements, that fund is invested in fixed income securities (e.g., bonds and other debt obligations), with no investment in equities (e.g., stocks).

In 2001, the legislature established a special subaccount of the budget reserve fund to be invested to yield a higher return than might be feasible in the main budget reserve fund. The subaccount was funded with a \$400 million transfer from the main budget reserve fund. The legislature instructed the Commissioner of Revenue to assume that the funds in the subaccount would not be needed for at least five years. Therefore, the subaccount was invested with a long-term time horizon. Given the draw on the main budget reserve account in the last several years and the anticipated draw in fiscal year 2004, it no longer seems reasonable to assume that the subaccount

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will not be needed in the next five years. The target asset allocation is shown on page 3. Footnote 1 on page 2 discloses return and market value information for the subaccount.

I would be happy to answer any questions you have on the investment of the CBRF.

Sincerely,

A handwritten signature in dark ink, reading "William A. Corbus". The script is cursive and fluid, with the first name "William" and last name "Corbus" clearly legible, and "A." in the middle.

William A Corbus
Commissioner

Enclosure

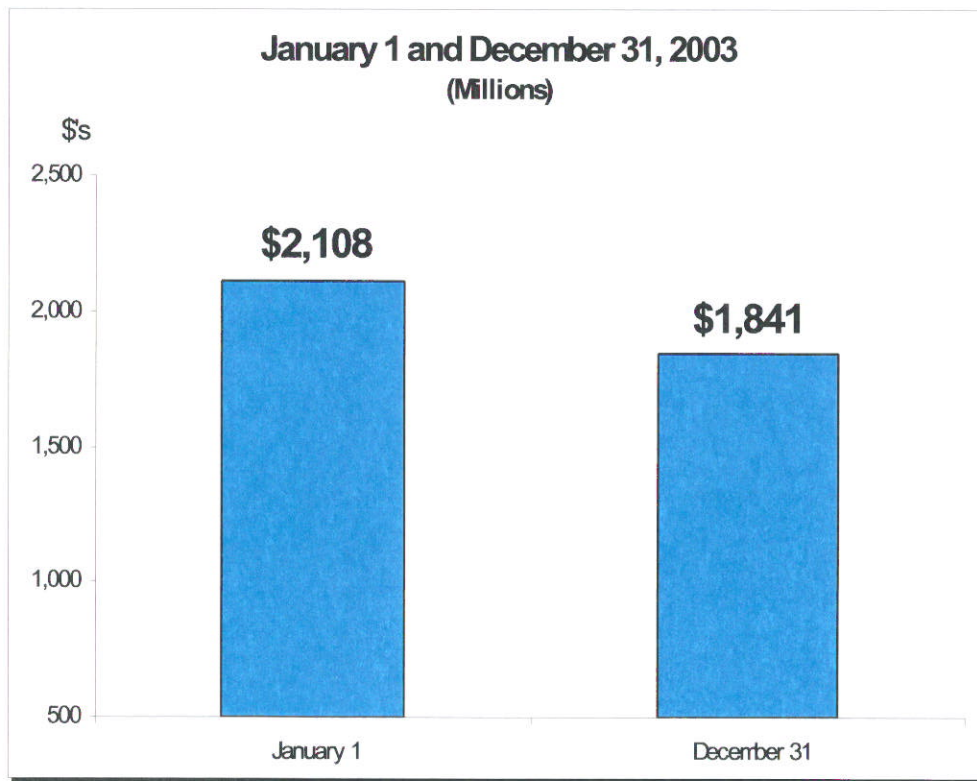
Department of Revenue
Treasury Division

Annual Report on the Constitutional Budget Reserve Fund

March 2, 2004

Sec. 37.10.430(b): *By March 15 of each year, the Department of Revenue shall, after consulting with the Alaska Permanent Fund Corporation, prepare a report setting out the balance in the budget reserve fund (art. IX, sec. 17, Constitution of the State of Alaska) on January 1 and on December 31 of the previous calendar year. The report shall state the nominal, real, and realized return on the budget reserve fund compared to the nominal, real, and realized return on the permanent fund and the general fund during the previous calendar year.*

Constitutional Budget Reserve Fund Balances



Department of Revenue
Treasury Division

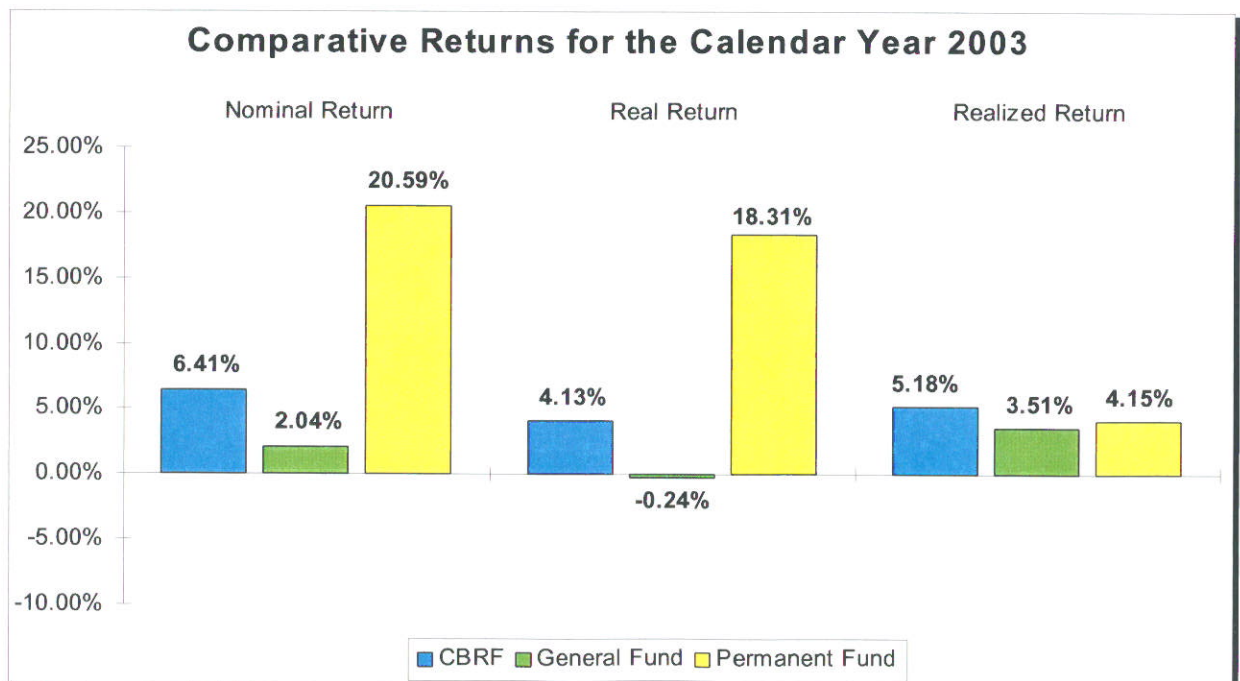
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2. Comparative Returns for Calendar Year 2003

Fund	Nominal (Total) Return ²	Real Return ³	Realized Return ⁴
Constitutional Budget Reserve Fund ¹	6.41%	4.13%	5.18%
General Fund ⁵	2.04%	-0.24%	3.51%
Alaska Permanent Fund Corporation ⁶	20.59%	18.31%	4.15%

- 1 Reflects the combined rates of return for the CBRF main account and subaccount. The subaccount alone had a total return of 19.17% for calendar year 2003. The main account alone had a total return of 3.49% for calendar year 2003. The market value of the subaccount at 12/31/2003 was \$409.8 million (approx. 22% of the combined fund).
- 2 State Street Analytics Performance Reports. Total return includes all components of investment income, including interest, dividends and realized and unrealized gains and losses.
- 3 Total return adjusted for the effect of inflation (2.28%) calculated by the Alaska Permanent Fund Corporation per AS 37.13.145 (c).
- 4 Custodial banks and external performance providers do not calculate a realized return. These amounts were calculated by staff of the Treasury Division as well as the Permanent Fund Corporation. Realized returns *do not* include unrealized gains and losses in investment income; therefore, comparisons between realized and total return have no meaning.
- 5 Does not include returns on the sale proceeds of Tobacco Settlement Revenue. Although part of the General Fund, these investments are managed by the Alaska Housing Finance Corporation and had balances of \$72.1 million and \$40.5 million on January 1 and December 31, 2003 respectively. This balance reduction is due to draws by State Agencies to cover expenditures appropriated from this funding source.
- 6 Provided by Alaska Permanent Fund Corporation.



Department of Revenue
Treasury Division

Cont'd: Annual Report on the Constitutional Budget Reserved Fund

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